

APEC Business Advisory Council (ABAC)

Finance & Economic Working Group (FEWG)

Paper from ABAC New Zealand relating to 2010 Work Program: Exchange Rates and Capital Flows

BUILDING A STABLE CURRENCY REGIME

Summary

1. The first paper on this topic was presented in Taipei when FEWG decided the matter should be the subject of further consideration. This paper proposes that ABAC consider promoting the creation of an APEC reserve currency, an APEC currency, which might be called the APECCU. The APECCU would not replace domestic currencies – it would not be a single currency for the region like the Euro is for the Eurozone economies. Economies would not be prevented from having exchange rate arrangements considered to be necessary or desirable for their own economies' monetary or other economic conditions. Their domestic currencies would adjust against the APECCU according to the arrangements they have in place.

Background

2. In Taipei, May 20, 2010, ABAC New Zealand made a presentation on exchange rates and capital flows¹. This occurred because development of a stable global financial and currency architecture and the strengthening of existing international institutions to support liberalisation and facilitation of trade and investment was a theme and priority of the 2010 FEWG work program agreed to in Melbourne, with Exchange Rates and Capital Flows being one of the identified topics under the heading of More Sustained Growth.
3. The Taipei paper stressed that exchange-rate volatility is an enemy of an open multilateral trading system and the free flow of goods, services and capital. It referred to the concerns expressed by ABAC members about the harmful consequences of volatility and exchange rate trends which had been exacerbated by the GFC.
4. For reference purposes the paper outlined exchange rate arrangements within APEC using an IMF publication on that subject. It produced statistical information concerning the movement against the USD of free floating currencies and managed arrangements. It considered the consequences of USD volatility and continuing

¹ Document: FEWG 30-017A

depreciation and referred to material indicating potential dangers for trade and investment, particularly arising out of agitation by some sections within the USA engendered by perceived concerns about the implications for US economic welfare of China's management of the RMB.

5. Having demonstrated the seriousness of the situation both in terms of the detrimental impacts already occurring and potential serious implications for the future, the paper then went on to consider the possibility of reform.
6. The paper noted pertinent remarks by Tommaso Padoa-Schioppa, President of Notre Europe and a former Minister of Economy and Finance in the Italian government.

In this lecture I shall be addressing the monetary aspect of the present economic crisis. My argument can be summed up in the following few propositions. The deep causes of this crisis include the dollar policy and, in a broader sense, the monetary regime that has been in force in the world for almost 40 years. Like the Bretton Woods system, it is incapable of imparting an acceptable macro-economic discipline to the world's economy because, being devoid of collectively accepted anchors, it encourages the persistence of unsustainable dynamics which spawn increasingly serious crises.

7. And quoted his conclusion.

Today, a multilateral trade and payments system already exists. It is not a matter of rebuilding it but of defending it against the constant and lethal dangers to which unsustainable monetary disorder exposes it. This disorder lies at the bottom of the crisis and no reform of finance failing to remedy it can provide a solid foundation for stability. The elements that are helping to keep this disorder alive are robust political and economic interests but also, and above all, the inertia of the practices currently in use and widespread intellectual inertia. The thoughts that I have expounded to you here tonight are an invitation to overcome that inertia.

8. It was suggested ABAC could play a part in seeking a solution to the unsustainable monetary disorder to which he referred.
9. When commencing consideration of possible pathways for reform the paper referred to suggestions by FEWG Chairman Mr Yoshihiro Watanabe that arguments over the future currency system could be classified into three categories:
 - (1) The creation of a new international reserve currency,
 - (2) The tri-polar system consisting of the dollar, the euro and a currency representing Asia, and
 - (3) Minor modification in the present dollar system.
10. The paper then referred to the contributions made by ABAC China during our 2009 meetings, noting that at the time of our February meeting in Wellington ABAC China's suggestion was along the lines of Mr. Watanabe's (2). ABAC China recognised that building necessary financial infrastructure was a required intermediary step towards formation of an Asian Currency.

11. ABAC China's thinking evolved after Wellington. In a paper presented in Brunei in May 2009 ABAC China identified four options: (1) Back to the gold standard, (2) Euro replacing US dollar as the core of international monetary system, (3) Diversified international monetary system and (4) Super-sovereign reserve currency.
12. ABAC China's preferred option was the Super-sovereign reserve currency (cf, Mr Watanabe's option (1)). The paper suggested an enhanced role for the IMF and contained a recommendation to use IMF Special Drawing Rights (SDR's).
13. A new global reserve system was also supported by the September 21, 2009 Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System (UN Report)². The ABAC New Zealand paper made extensive reference to the UN Report.
14. The paper had the following conclusions.
 1. The weight of opinion appears to favour a new global reserve currency. The UN Report says, "this is an idea whose time has come".
 2. The UN Report's thrust is that it is not a question of whether there should be a new global reserve currency, but rather the form it should take and the steps needed to put it in place.
 3. The Report says the currency could be defined by reference to a basket of currencies -- SDRs or like SDRs. It also suggests the possibility of the global currency being defined by the equivalent to a system of worldwide "swaps" among central banks with [economies] exchanging their own currencies for the new currency so that the global currency would be fully backed by a basket of the currencies of all economies and it mentions some variations on that general theme.
 4. Within any of the variations referred to in paragraph 70, economies could have exchange rate arrangements similar to the variety which already exist (refer the IMF's AREAER classifications as discussed above) as between the domestic currency and the global currency, so long as an economy's actions did not have an impact on any other economy. This, seemingly, would allow economies to retain autonomy with respect to domestic monetary conditions.
 5. Finally, what should ABAC do? In the first place, we need to decide whether as a general proposition ABAC should consider the matter further. The aim of further consideration would be to reach a firm view on whether or not a global reserve currency is something to be promoted by ABAC; if so, what form it might take and how the proposal might be advanced. In short, it is suggested that FEWG should receive input from members before deciding if and how the matter is to proceed.
 6. If we did decide to proceed further ABAC could work to advance the proposal to the point of being able to make a recommendation to Leaders. A global reserve currency might then become an APEC initiative to be advanced to the rest of the international community. Alternatively ABAC might decide to advance to Leaders the development of a reserve currency for the region either in its own right (possibly as in line with Mr Watanabe's Option (2)) or as an evolutionary step towards a new global reserve currency as posited by the UN Commission of Experts.

² http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf

15. In Taipei it was decided that as a general proposition ABAC should consider the matter further.
16. This present paper has the purpose of seeking to advance those considerations.

Subsequent events

17. The situation has deteriorated since Taipei.
18. Volatility, renewed depreciation of the USD and prospective continued depreciation arising from likelihood of further quantitative easing and other measures, volatility exacerbated by sovereign debt crises and other problems in the Eurozone, China's management of the RMB and tensions arising from it have made the situation even more serious.
19. In relation to the last point, on 29 September the US House of Representatives passed the Currency Reform for Fair Trade Act by a vote of 348 to 79. This is "An Act to amend title VII of the Tariff Act of 1930 to clarify that countervailing duties may be imposed to address subsidies relating to a fundamentally undervalued currency of any foreign country". It has yet to be passed by the Senate but commentators believe endorsement by the Senate after the November mid-term elections is a foregone conclusion.³
20. It would be in the interests of the US and China, and derivatively of all economies, to have this source of tension and potential damage to the global economy eliminated. That matter of critical importance is in addition to the overwhelming advantages for free trade and investment of a stable global financial and currency architecture.

Pathway to reform

21. We are ABAC, the Asia Pacific Economic Cooperation Business Advisory Council. In their 1993 Blake Island declaration the Leaders stated "As members of APEC, we are committed to deepening our spirit of community based on our shared vision of achieving stability, security and prosperity for our peoples"⁴. If ABAC decides to promote a solution, that solution should be firmly grounded on the principle of economic cooperation.
22. That means cooperation between all APEC economies. The tri-polar approach is inconsistent with cooperation between all APEC economies, and it would involve economies outside APEC, so it cannot be an ABAC initiative.
23. The scale of the problem makes minor modification to the present dollar system an inadequate response.

³ If adopted by the Senate it will then be subject to Presidential consideration and possible veto.

⁴ http://www.apec.org/apec/leaders_declarations/1993.html

24. If for these reasons the tri-polar approach and minor modification of the present system are eliminated that leaves for consideration as the pathway for reform the creation of a new international reserve currency, or a variation of it.
25. ABAC New Zealand proffers for consideration a variation of the UN Report's proposal for a new global reserve currency. It is proposed that ABAC consider promoting the creation of an APEC reserve currency, an APEC currency, perhaps the APECCU. The following paragraphs outline why it should be given consideration by ABAC and in doing so advance some tentative suggestions about how it might be structured.
26. ABAC's position is as a Business Advisory Council for APEC so it is within APEC that we must work. However, if the proposal were taken up by APEC then, as has happened in other cases, this might in itself be the catalyst for wider international action.
27. The differences between the APECCU suggestion and the tripolar approach is that all APEC economies, including the US, will participate in an APEC solution, in the spirit of co-operation which has traditionally characterised APEC deliberations and actions.
28. APEC's 21 members include the world's three largest economies, account for approximately 40.5% of the world's population, approximately 54.2% of world GDP and about 43.7% of world trade. APEC is probably better placed than any other institution to advance and achieve a concrete solution. It has the experience of successfully advancing free trade and investment to the manifest benefit of the economies of the region. This initiative is a logical extension and a product of the vastly changed global economic conditions.
29. In Bogor, in November 1994, the APEC Economic Leaders came together to chart the future course of economic cooperation to enhance the prospects of an accelerated, balanced and equitable economic growth not only in the Asia-Pacific region, but throughout the world as well.
30. The emphasis at Bogor was on strengthening the multilateral trading system; enhancing trade and investment liberalization in the Asia-Pacific; and intensifying Asia-Pacific development cooperation.
31. Last year at the November Singapore Summit the Leaders agreed to formulate an APEC Growth Strategy to shape the region's growth following the Global Financial Crisis.
32. What is common to the Bogor declaration and the APEC Growth Strategy is at the heart of Asia-Pacific Economic Cooperation. The heart of APEC is the underlying purpose of seeking improvement of the material standard of living of all the peoples of the region. Whilst there is still much to be done, much has been achieved.

33. The APEC region has become the world's growth centre by promoting free and open trade and investment and strengthening regional economic integration (REI). Recognizing that liberalization and facilitation of trade and investment will contribute to growth in the APEC economies, APEC economies are continuing their efforts to achieve further growth in the region by structural reform and REI.
34. In last November's Singapore declaration Leaders said.
- Looking beyond supporting the recovery, we recognise the necessity to develop a new growth paradigm for the changed post-crisis landscape, and an expanded trade and investment agenda that will strengthen regional economic integration (REI) in the Asia-Pacific region.
35. REI is now seen as having a wider vision beyond the previous focus which was very much trade and investment related. In a Conference on Asia-Pacific Regional Economic Integration and Architecture in Auckland, New Zealand, on 25 March 2010, APEC's Executive Director, Ambassador Noor, described the outcome of the Singapore Summit as producing a new vision. "This 'new vision' for APEC in fact points to a broadening of the APEC agenda, from trade and investment liberalisation per se, towards broader economic policy coordination. The new paradigm, and the related reference to "the changed post-crisis landscape", underlines an APEC that is dynamic and that will remain relevant in the fast-changing economic environment."⁵
36. Whilst Ambassador Noor did not have an APEC currency in mind when he made that statement, we have indeed been thrust into a fast changing economic environment within which monetary disorder is arguably the greatest threat to "our shared vision of achieving stability, security and prosperity for our peoples"⁶. A dynamic APEC could respond to that threat and ABAC whose concern about the problem has led to the issue being on the FEWG's work program for 2010 could take the lead. As business people, we are at the cutting edge of the problems arising from monetary disorder and its particular manifestation of exchange-rate volatility.
37. Currency reform has not heretofore been part of REI but it would be the most effective single tool to move the APEC economies towards the stability, security and prosperity for our peoples which will be promoted by further economic integration. It will remove or at least mitigate the instability which has been so readily apparent since the GFC and more particularly in recent months. By doing so it will enhance security in the region. A stable financial and currency architecture will by its assistance to free and open trade and investment enhance the prosperity of our peoples.

What would be involved

38. In broad terms this is how it might work.

⁵ http://www.apec.org/apec/news_media/speeches/250310_nz_rei.html

⁶ Blake Island Declaration, see above.

39. The APECCU would not replace domestic currencies – it would not be a single currency for the region like the Euro is for the Eurozone economies. Economies would not be prevented from having exchange rate arrangements considered to be necessary or desirable for their own economies' monetary or other economic conditions⁷. Their domestic currencies would adjust against the APECCU according to the arrangements they have in place.
40. The APECCU's value would fluctuate. SDRs provide an example of a mechanism which might be employed. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of four key international currencies, and SDRs can be exchanged for freely usable currencies. It is calculated as the sum of specific amounts of the four currencies valued in U.S. dollars, on the basis of exchange rates quoted at noon each day in the London market. The basket composition is reviewed every five years by the IMF's Executive Board to ensure that it reflects the relative importance of currencies in the world's trading and financial systems⁸.
41. The APECCU's value could be fixed in a similar way but would be based on a basket of the 21 APEC currencies⁹. The value of the APECCU would fluctuate according to the fluctuation of the currencies in the basket. This means movements in the exchange rates of the larger economies would have greater influence than movements in the smaller economies, but the impact would be indirect and fluctuations might tend to cancel each other out. Even if that did not occur, there would be diversification unlike the present situation where changes in monetary conditions in the US have an immediate and direct impact on exchange rates.
42. If the APECCU replaced national currencies for trade and investment within the region (which, after all, is the objective) there might not then be a market in the national currencies to enable its value to be determined in the way the SDR's value is determined. If that were to be the case some other means of settling its value would have to be designed. There are discussions of such matters in the UN Report.¹⁰
43. An agency would have to be created to be the issuer of the APECCU. Once again, the UN Report discusses possibilities, albeit in relation to a global currency, but the suggested possibilities could be the starting point for considering what might be done within APEC.

⁷ Refer the IMF's AREAER classifications as discussed in my earlier paper

⁸ See IMF Fact Sheet: <http://www.imf.org/external/np/exr/facts/sdr.htm>.

⁹ QFINANCE Dictionary Finance and Business Dictionary definition of basket of currencies: a group of currencies, each of which is weighted, calculated together as a single unit in establishing a standard of value for another unit of currency.

¹⁰ http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf, para 32 et seq.

44. Conclusion
45. The UN Report said in September 2009, “This is an idea whose time has come”. It has become progressively more clear that this is so. If we consider APEC values to be values which should be implemented in practice, steps need to be taken to mitigate the impact of monetary disorder.
46. ABAC can sit back and do nothing on the basis that it is too hard or that it is for someone else. Alternatively, as the independent voice of business within the APEC process we can respond to what is one of the most pressing challenges for business in the region by seeking to promote reform of the system.
47. The paper presented at Taipei asked for input from members which was given. FEWG decided further consideration should be given to the broad issue of whether or not a global reserve currency is something to be promoted by ABAC. ABAC New Zealand has taken account of views expressed at Taipei and has concluded that it is more appropriate for ABAC to consider what might be done within the APEC region. That has resulted in this paper’s suggestion for an APEC currency.
48. FEWG needs to decide whether further consideration should be given to that proposal. As in Taipei, input from members is requested.

Gary Judd QC
ABAC New Zealand
October 22, 2010